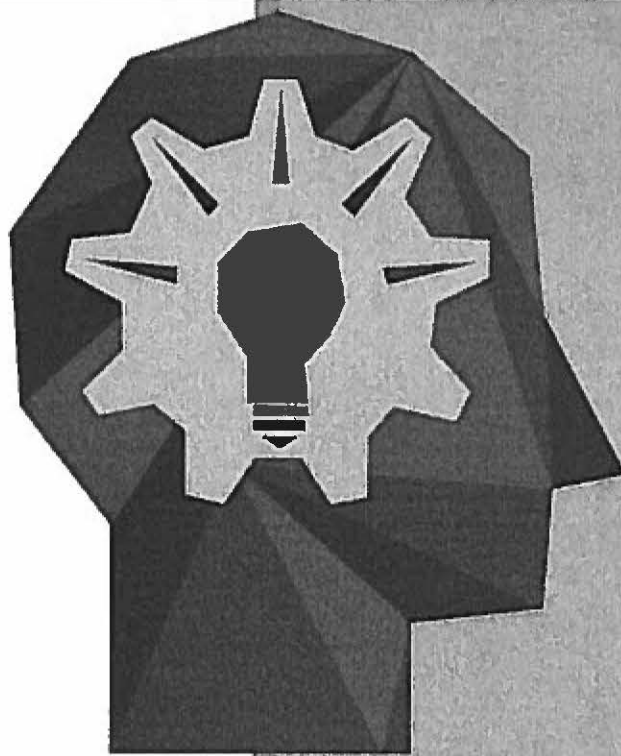


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Intellectual Property Protection: Key to Accelerating Indonesia's Economic Growth



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Table of Contents

Introduction.....	3
Indonesia's Economic Potential to Counter China.....	4
Factors Inhibiting Economic Growth	6
Intellectual Property Protection in Indonesia	7
Benefits to Indonesia of Improved IPP	8
Increase Regional Trade	9
Augment Foreign Direct Investment.....	11
Escape the Middle-Income Trap.....	12
Counterarguments.....	13
Recommendations.....	14
Conclusion	15

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Abstract

Intellectual Property Protection: Key to Accelerating Indonesia's Economic Growth

Indonesia has the potential to check China's economic dominance in the region given its population, natural resources, and relatively low level of fiscal debt. However, Indonesia's growth has begun to stagnate because of its trade protectionist policies, poor business climate—including limited intellectual property protection (IPP)—and underdeveloped infrastructure. Improving Indonesia's IPP is a key facet to stimulating growth in Indonesia's economy. Indonesia's poor IPP record prevents it from joining key free trade agreements and constrains trade with the United States. Moreover, sound IPP encourages foreign direct investment and is a crucial enabler for middle-income countries, like Indonesia, seeking to transition to a high-income, knowledge-based economy. Therefore, to empower Indonesia to improve its economic growth and realize its potential to serve as an economic balancer against China, Washington has the opportunity to work with Jakarta to improve its intellectual property protection to foster increased Indonesian trade, improve its infrastructure, and contribute to Indonesia's ability to transition to a knowledge-based economy.

Introduction

“The relationship between the United States and Indonesia has long underperformed its potential,” said Joshua Kurlantzick, senior fellow for Southeast Asia at the Council on Foreign Relations.ⁱ One of the key areas where this statement is exemplified is in the economic realm. As Vice President Pence said during his visit to Indonesia in April 2017, “we still have room for significant progress” to assist Indonesia’s continued economic development.ⁱⁱ Indonesia is facing a period of stagnated economic growth and is underperforming its potential because of its trade protectionist policies, poor business climate, and underdeveloped infrastructure. All of these issues are affected by Indonesia’s poor record for intellectual property protection (IPP). In 2018, the Global Innovation Policy Center (GIPC) ranked Indonesia 41st out of 50 countries studied in terms of IPP.ⁱⁱⁱ The state of Indonesia’s IPP laws disqualifies the country from key regional economic trade agreements and disincentivizes US businesses from operating in Indonesia. Improving its IPP would likely increase its foreign investment into the country and would lay the groundwork for Indonesia to transition to an advanced, knowledge-based economy—an economy that relies more on technological and scientific advancement than physical industries. Bringing its IPP laws and regulations more in line with the standards of advanced economies would accelerate economic growth in Indonesia.

However, US interest in Indonesia’s economic prosperity should not just be focused on fostering opportunities for US businesses, it should be encompassed into a larger geoeconomic strategy to counterbalance China’s economic influence in the region. China seeks to become a regional hegemon in the Pacific. One way it seeks to accomplish this goal is by rapidly growing its economy and manipulating its neighbors into dependency on China. To thwart Beijing’s plans, the US will need strong economic allies in the region that are less vulnerable to China’s aggressive economic strategies. As the third largest democracy in the world and the largest

economy in Southeast Asia, Indonesia represents an excellent candidate to serve as an economic check against China.^{iv} To enable Indonesia to improve its economic growth and realize its potential to serve as an economic balancer against China, Washington has the opportunity to work with Jakarta to improve its intellectual property protection to foster increased Indonesian trade, improve its infrastructure, and to contribute to Indonesia's ability to transition to a knowledge-based economy.

Indonesia's Economic Potential to Counter China

Indonesia has a robust and resource-rich economy that could serve as an economic check on China's growing economic dominance in the region. Whereas other countries in the region are becoming increasingly dependent on China for their economic prosperity, Indonesia has many economic strengths that make it less susceptible to influence. With a gross domestic product (GDP) just over a trillion dollars, Indonesia is currently the 16th largest economy in the world and the largest economy in Southeast Asia.^v It is the world's leading supplier of palm oil, the second leading supplier of coal and the second leading producer of cocoa and tin, providing Indonesia with a rich export potential to fuel economic growth.^{vi} What's more, one of Indonesia's major sources of geoeconomic strength is the size of its demand market. In 2012, McKinsey Global Institute reported that there were 45 million members of the consuming class in Indonesia and that number could grow to 135 million by 2030.^{vii} Indonesia is not reliant on Chinese demand for its products to foster economic growth, thus diminishing the impact of a key economic lever that China could use against Jakarta. For example, if China instituted trade barriers against Indonesia to get Indonesia to capitulate on a key political or military issue, Indonesia has enough domestic demand for its products that the impact of the trade barriers would be less than it would for other countries in the region.

Other factors that limit Beijing's influence over Indonesia and create opportunities for Jakarta to challenge China's economic dominance in the region are competition for manufacturing contracts, Indonesia's relatively low debt, and steady growth. Indonesia and China are both mostly labor-based economies, so they compete for manufacturing contracts that require cheap labor. While China's population is aging and its birth rate is declining, according to its own National Health Commission's figures, Indonesia's population is relatively young and is growing, based on the McKinsey Global Institute study.^{viii} In 2012, Indonesia had 55 million skilled workers and that number is expected to grow to 113 million by 2030.^{ix} Thus, Indonesia will be a more favorable place for large manufacturing contracts. Competition with China in this area will create friction between the two, possibly limiting China's influence with Indonesia. In addition, one tactic China uses to gain influence in the region is what is often being called "Debt Diplomacy:" issuing credit to fiscally-strapped countries that cannot obtain a loan from any other source. However, according to the same study by the McKinsey Global Institute, Indonesia's "government debt as a share of GDP has fallen by 70 percent ... lower than in the vast majority of advanced economies."^x So, Indonesia is not as vulnerable to China's attempts to use debt to gain influence.

Finally, economists predict that by 2030, Indonesia could become the 7th largest economy in the world. This would make Indonesia the third largest economic power in the Pacific, second only to China and Japan in the region.^{xi} Although China is and will be a stronger economic powerhouse than Indonesia, Indonesia's economic strength in the region could serve as a check against China's dominance. Countries that rely on China as a consumer of their exports can turn to Indonesia's growing consumer demand as an alternative. Moreover, if Indonesia built strong

economic alliances with US allies such as Japan and Australia, it would create a strong economic coalition that could balance the strength of China.

Factors Inhibiting Economic Growth

Despite its potential, Indonesia's economic growth has slowed because of its trade protectionist policies, poor business climate, and underdeveloped infrastructure, all of which are influenced, in part, by the level of intellectual property protection. During the past five years, Indonesia failed to meet its goals for economic growth. The government seeks to achieve approximate 7 to 8 percent growth per year to achieve its goals of becoming one of the 10 largest economies in the world. Since 2014, however, Indonesia's GDP growth has rested at around 5 percent.^{xii} A country's GDP is made up of government spending, consumption, investment, and trade. Approximately 65% of Indonesia's GDP was domestic, according to the McKinsey Global Institute study, so its economy is largely driven by consumption as opposed to trade. Indonesia has set up a number of trade barriers that both limit imports and restrict exports.^{xiii} In 2015, Indonesia was ranked fourth in terms of imposing measures that harm foreign commercial interests.^{xiv} This reliance on consumption provides stability for Indonesia but limits its rate of economic growth. Consequently, Indonesia has been unable to hit its growth target of 7 to 8 percent growth per year. To increase its economic growth, Indonesia will need to increase one of the other components of GDP. Increasing trade offers the potential for increased economic growth without increasing debt. Later on, this paper will discuss how improving its IPP laws will pave the way for Indonesia to join a key trade agreement that would help to accelerate Indonesia's economic growth.

Other factors slowing Indonesia's economic growth are its poor business climate and infrastructure. Indonesia has a less favorable business climate than many other countries in the

region, and that climate has served as a deterrent to trade. In 2017, Indonesia ranked 72 out of 190 in the World Bank's Ease of Doing Business Survey.^{xv} One aspect of Indonesia's poor business climate is its limited protections against intellectual property theft. In 2018, Indonesia was one of 12 countries listed on the U.S. Trade Representative Priority Watchlist for insufficient intellectual property rights protections.^{xvi} Indonesia's poor record in this area serves as a trade barrier for companies that rely on IPP to uphold their patents and copyrights.

Another factor inhibiting Indonesia's economic growth is its infrastructure. After he took office in 2014, Indonesia President Widodo launched an ambitious plan to improve Indonesia's infrastructure that included plans for 222 projects to build railways, roads, and bridges.^{xvii} The goal of this plan was to stimulate economic growth. Indonesia has an approximate infrastructure gap of \$1.5 trillion compared to other emerging economies, according to the World Bank.^{xviii} Indonesia's poor infrastructure creates logistical hurdles that increase the cost of doing business, providing a disincentive for businesses to operate in Indonesia. Widodo still needs an additional \$150 billion to complete his plan.^{xix} Most of his infrastructure plan is privately financed, so to continue its infrastructure improvement, Indonesia needs increased foreign direct investment (FDI).^{xx} Studies have shown a positive link between IPP and increased investments in both research and development and FDI, suggesting that one way to improve Indonesia's infrastructure is to improve its IPP laws.^{xxi} William Lesser, an economist at Cornell University, showed that a 10 percent increase in IPP resulted in a \$1.5 billion increase in FDI.^{xxii}

Intellectual Property Protection in Indonesia

Indonesia's IPP is substandard and far below that required to foster new industries that could bring higher income jobs. As stated earlier, the GIPC, an affiliate of the United States Chamber of Commerce, has ranked Indonesia 43 out of 50 countries studied in terms of IPP.

Developing countries, like Indonesia, often have poor IPP records because counterfeit goods cost less, and consumers in those countries either cannot or do not want to pay for higher-priced, brand-name goods. One reason for Indonesia's low ranking is its minimal participation in international intellectual protection treaties. In addition, one of the most cited criticisms of Indonesia's IPP is its 2016 patent law that requires all patented technologies to be manufactured in Indonesia and all technology processes to be used in Indonesia.^{xxiii} Meaning, companies wanting to do business in Indonesia would have to agree to manufacture their products in Indonesia to be granted patents, which serves as a strong disincentive to operate in Indonesia. The GIPC also highlights that it is more difficult for pharmaceutical companies to obtain patents because it places more stringent requirements than other countries to demonstrate the effectiveness of the drug. Moreover, Indonesia has a high rate of piracy due to its difficult copyright environment.^{xxiv} The International Intellectual Property Alliance assessed that Indonesia has 18 million instances of pirated movies, music, and software available to its markets in an average month.^{xxv} Consequently, Indonesia's high requirements to acquire patents, erroneous requirements for technology transfer, and high rates of piracy discourage knowledge-based industries, such as pharmaceuticals, the arts, and emerging technologies from participating in Indonesia's economy, despite the benefits that come with Indonesia's large workforce and strong consumer base.

Benefits to Indonesia of Improved IPP

If Jakarta is able to overcome deficiencies with its intellectual property protection laws, it would facilitate increased trade within the region and with the United States, augment foreign direct investment, and help it avoid the Middle-Income Trap.

Increase Regional Trade

One benefit Indonesia would get from improving its IPP is the ability to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). In April, Indonesia's Finance Minister announced that Indonesia was investigating the possibility of joining the CPTPP—formally referred to as the Trans-Pacific Partnership (TPP).^{xxvi} Prior to this year, Indonesia had decided not to pursue membership because the United States had pulled out of the agreement, and Jakarta saw free-trade with the United States as the biggest incentive to join, according to Indonesian Vice President Jusuf Kalla.^{xxvii} Now, Indonesia sees joining the CPTPP as a way to compete more effectively in key manufacturing sectors, enabling it to reach its goal of becoming one of the top ten economies in the world.

The CPTPP sets high standards for the IPP that Indonesia will need to address before joining, but the agreement is not as restrictive as the TPP and may be easier for Indonesia to implement. The Center for Strategic and International Studies (CSIS) contends that the CPTPP “offers the most advanced and detailed standards on intellectual property in a trade agreement to date.”^{xxviii} To join, Indonesia would have to make changes to its internal laws to make its procedures for obtaining patents, trademarks and copyrights more transparent and in line with international standards and sign onto several treaties regarding IPP, including the Budapest Treaty, Singapore Treaty and the International Convention for the Protection of New Varieties of Plants.^{xxix} Although Indonesia signing onto the CPTPP will require Indonesia to make some systemic changes to its IPP, those changes would be less invasive than the original TPP agreement's provisions and may be more palatable for Indonesia. Vice President Kalla stated that the government was investigating the costs and benefits of joining the CPTPP and expects to have a decision sometime in 2019.^{xxx}

Despite the costs, joining the CPTPP could increase Indonesia's relative power in the region. The Lowy Institute created an analytic tool to measure relative geopolitical power in Asia, called the Asia Power Index. It examines how Asian states perform in 114 indicators of state power in relation to others in the region. According to this study, Indonesia ranks 10th out of 25 Asian states in terms of geopolitical power. However, the Lowy Institute dubs Indonesia as an "underachiever" in overall power, because "the country wields less influence in Asia than would be expected from its resources." One of the reasons for this disparity is its low rankings in economic relationships, according to the Lowy Institute.^{xxxix} Joining the CPTPP would enable Indonesia to form stronger economic relationships and increase its relative power rankings to wield more influence in the region. So, not only would Indonesia enjoy an uptick in economic growth through the increase of trade, it could also enjoy a greater prominence in the region. In this way, the United States would benefit from Indonesia joining the CPTPP, even without joining the agreement itself, because it would tie Indonesia economically to US allies in the region. Australia, Canada, Japan, and New Zealand are all signatories and strong US allies.^{xxxix} Moreover, as China's economic competitor, improvements to Indonesia's relative power could pull influence away from China.

Improving its IPP would also establish a more favorable business environment for US companies. In 2017, Vice President Pence stated that improving US economic ties to Indonesia is a top priority, and the US Embassy in Jakarta made facilitating increased market access for US businesses its number one mission objective.^{xxxix} The reason for this emphasis is that the United States faced a \$13.3 billion trade deficit with Indonesia in 2017 as a result of Indonesia's protectionist policies. By June 2018, trade representatives from the United States and Indonesia had "agreed to work together to address outstanding issues."^{xxxix} However, even if Jakarta

removed all of its tariffs and export taxes that impede trade with the United States, Indonesia's poor record for IPP would still serve as a disincentive for US companies to do business in the country. As stated previously, Indonesia is on the United States' watchlist for countries with poor IPP. At the June trade meeting, Indonesia did agree to a formal roadmap to address US concerns regarding Indonesia's IPP, according to the United States Trade Representative.^{xxxv} It is unclear, however, to what extent Indonesia will hold to this agreement in light of increased trade tensions in the region and Indonesia's 2019 Presidential election, but it is a step in the right direction.

Augment Foreign Direct Investment

Another benefit of Indonesia improving its IPP is that it could foster additional foreign direct investment. Economists Lee Branstetter and Kamal Saggi conducted a study to model how strengthening intellectual property rights (IPR) would impact foreign direct investment in southern countries that tend to be less developed than their northern counterparts. They conclude that "strengthening of IPR protection in the South fosters innovation... increases FDI to a degree that the Southern production base actually expands." Branstetter and Saggi's analysis suggests that protections against intellectual property theft would create an environment that would grow Indonesia's industrial base, thus improving its economy.^{xxxvi} As discussed earlier, Lesser showed that even a 10 percent increase in IPP can increase FDI by about \$1.5 billion.^{xxxvii} He also demonstrated that although there are other factors that affect FDI—trade protectionist policies, access to global markets, and a strong business climate—holding all those constant, there is still a positive and statistically significant relationship between IPP and FDI.^{xxxviii} Increasing FDI would increase the country's GDP because it is counted as investment, one of the four contributors to GDP. In addition, FDI is often used to improve infrastructure, which is badly needed in Indonesia.

Singapore is a real-world example of the link between IPP and FDI. Singapore ranks fourth in the world in favorable IPP, and it is ranked seventh in the world for the amount of FDI in its economy.^{xxxix} So, if Indonesia seeks to increase its foreign investment, particularly in its infrastructure, Singapore's experience would suggest that increased IPP could provide a strong motivator for foreign investors. In addition, since China and Indonesia are competitors in a lot of ways, Indonesia improving its IPP could attract investors that would have otherwise invested in China, a country that has weak IPP.^{xl}

Escape the Middle-Income Trap

In order for Indonesia's economy to escape the slowdown in economic growth that has been common in middle-income countries—often referred to as the Middle-Income trap—it must join the global knowledge economy by improving its IPP. In the 1990s, a phenomenon began to emerge where low-income countries, who could offer cheap labor, would rely on labor-intensive industries to rapidly grow their economies. Once they achieved middle income status, however, their economic development started to slow because their developing middle class meant that they could no longer offer the same low wages as low-income countries. Middle-income countries could not maintain their upward trajectory to achieve high-income status and thus began to stagnate. The phenomenon became known as the “Middle-Income Trap.”^{xli} Indonesia achieved middle income status in 2003.^{xlii} In 2012, Indonesia was experiencing 6.5 percent growth, but Indonesia's growth has slowed since 2014 where growth has steadied at around 5 percent, suggesting Indonesia is beginning to experience the Middle-Income Trap and will need to take measures to accelerate its growth if it wants to transition to a high-income country.^{xliii}

For the time being, Indonesia can still offer cheap labor for labor-intensive industries. As its growth accelerates and more of its population enters the middle class, Indonesia will need to

transition to a knowledge-based economy to achieve the high-income status that it seeks.

Geoffrey Garrett, a political science professor wrote in Yale Global that middle-income countries have to “tech up” in order to escape the Middle-Income Trap. Essentially, he argues that in today’s economy, middle income countries are trapped because they either have to dumb down their economies to compete in labor markets or they have to compete against high income countries in the knowledge market. The only way to do this is to promote technological innovation.^{xliv} Intellectual property protection is key to fostering technological innovation. Strong IPP provides guarantees that creators will reap the benefit of their ideas, whereas countries that have poor IPP create disincentives for technological innovation because creators are less likely to realize the full benefits from their ideas. Tech companies also bring high paying jobs. Countries with strong IPP have an income per capita that is thirteen times higher than countries with poor IPP.^{xlv} Therefore, if Indonesia is going to compete effectively against knowledge-based economies, it needs to improve its IPP.

Counterarguments

Some argue that increasing IPP harms developing countries while shielding developed countries. Essentially, improving IPP raises the prices of goods, so domestic consumption decreases. As shown earlier, Indonesia relies heavily on domestic consumption for its economic growth. However, this argument fails to consider the fact that improving Indonesia’s IPP could increase trade, an underachieving factor in Indonesia’s GDP. In addition, increasing free trade with its neighbors will lower prices of imported goods, which could ameliorate the impact of strengthened IPP on the price of goods that are prone to counterfeit. Finally, creating the conditions for Indonesia to transition to a knowledge-based economy will more than compensate for a short-term increase in prices.

Other critics of US engagement with Indonesia argue that Indonesia is unlikely to align itself with the West to counter China as it is a founding member of the Non-Aligned Movement. Mark Valencia, Senior Fellow at the East West Center, argues in a February 2018 article in *The Diplomat* that Indonesia is unlikely to ally politically and militarily with the United States because of Indonesia's shift from regional issues to domestic issues, past US support for former Indonesian dictator Suharto, and US criticisms of some of Indonesia's maritime claims.^{xlvi} Valencia astutely challenges the extent to which Indonesia and the United States have common political or military interests; however, he does not take into account Indonesia's economic interests. President Widodo said in 2016 that "economic integration is the current global trend. And economic integration must bring benefit and prosperity for the people."^{xlvi} Indonesia's economic interests will drive it towards cooperation with allies in the region, even if Jakarta remains neutral politically and militarily.

Recommendations

President Widodo is up for reelection in 2019, creating a window of opportunity in which he may be more inclined to make changes to secure economic deals that will promote Indonesia's economy and secure his reelection. Given his reelection campaign, Widodo is more likely to be responsive to the carrot rather than the stick. He needs to be seen as bringing economic prosperity to his country as opposed to being weakened by foreign threats of tariffs. Therefore, the U.S. Trade Representative and Department of State should offer economic incentives, such as reduced trade barriers or foreign direct investment, as an incentive to induce Indonesia to improve its intellectual property laws. Moreover, the U.S. State Department should encourage economic NGOs and US allies in the region, particularly Singapore, to engage with Indonesia regarding its IPP and how to make reforms. Finally, US companies wanting to expand their business in Indonesia should initiate a public awareness campaign to educate the local

populace of the importance of protecting intellectual property with the aim of curbing the rate of piracy in the country. These efforts to improve Indonesia's IPP, if successful, will not only foster opportunities for US businesses, but will also enable accelerated economic growth in Indonesia by improving trade, increasing foreign investment, and paving the way for Indonesia to transition to a knowledge-based economy.

Conclusion

Indonesia is at a critical point in its economic development. It is in the interest of the United States for Indonesia to achieve its economic potential. Not only will US businesses benefit from increased trade with Indonesia, but Indonesia's democratic society and economic strength could serve as an economic check on China's growing prominence in the region. However, Indonesia's poor record for IPP will continue to hamper its economic growth. It is imperative that Indonesia adjusts its intellectual property laws to be more in line with those of knowledge-based economies so that it can facilitate increased trade, avoid a prolonged economic slowdown, and lay the groundwork to enable Indonesia to become a high-income economy.

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